This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 HARARE 001492

SIPDIS

AF/S FOR B. NEULING
NSC FOR SENIOR AFRICA DIRECTOR C. COURVILLE
AFR/SA FOR LOKEN, COPSON
TREASURY FOR RALYEA, CUSHMAN

E.O. 12958: N/A
TAGS: EFIN ECON PGOV ZI
SUBJECT: CORRECTED COPY - NEW FOREX TRADING REGIME - A LOT LIKE THE OLD ONE

REF: HARARE 01485

Summary

¶1. (SBU) In his Monetary Policy Review Statement for the third quarter of 2005, Reserve Bank of Zimbabwe (RBZ) Governor Gono announced numerous policy shifts, many of which centered around replacement of the auction system of foreign currency allocation by a system intended to be largely governed by market forces. The new regime was supposed to allow businesses to retain more forex for longer periods and to allow them to remit more of it at a new interbank rate. However, as the interbank rate quickly closed in on the parallel market rate at the start of this week, Gono forced the commercial banks to agree on a compromise rate halfway between the auction and parallel market rates. Forex trading has now ground to a standstill on lack of confidence by traders in the GOZ's commitment to let market forces drive the rate. One prominent businessman told the Ambassador this week that the business community was already convinced nothing had really changed. End Summary.

One Step Forward

¶2. (U) The Monetary Policy Review Statement for the third quarter of 2005, presented by Gono on October 20 announced the replacement of the auction system with a new forex management system, dubbed the "Tradable Foreign Currency Balances System." According to Gono, the new system would allow exporters to retain 70 percent of their export proceeds and requires them to remit the remaining 30 percent at the official auction exchange rate (previously the split had been 50:50). Gono pegged the official exchange rate at the prevailing rate of Z$26,000/US$ but said the rate would be adjusted "from time to time".

¶3. (U) Gono said the new exchange rate regime would also allow corporate foreign currency account (FCA) balances to be retained for 45 days, after which the balance would be liquidated at the interbank rate. (N.B. The retention period had been 30 days, with liquidation at the official rate.) Holders of free funds, including individuals, NGOs, embassies, international organizations and Zimbabweans in the diaspora, would be allowed to sell their foreign exchange at the interbank market. All importers, save for critical Government functions, would also access foreign exchange at the interbank market. (N.B. Gono's full monetary statement is available at:
http//www.rbz.co.zw/mpolicy/mpolicycontents20 04.asp)

¶4. (SBU) In presenting the Monetary Policy Review Statement to the diplomatic community early on October 21, the day after his national address, Gono said that the new system was recognition on the part of the GOZ (or at least the RBZ) that the market was the best allocator of scarce resources, including forex. However, he added, for now the RBZ could not allow all forex derived from exports to be exchanged at the interbank rate.

One Step Back

¶5. (SBU) Banking sector contacts told EconOff that Gono subsequently met with foreign exchange department heads of Zimbabwe,s commercial banks to discuss how to arrive at the "market-determined interbank rate." Numerous bankers at the meeting reportedly argued for full liberalization of the exchange rate, but Gono responded that a floating exchange rate would quickly rise to the parallel market rate given the lack of liquidity in the banking sector. The marathon meeting was inconclusive; no banks traded foreign currency on October 21.

¶6. (SBU) On Monday October 24, a few banks opened forex trading at rates as high as the parallel market rate of Z$90,000-95,000, others set rates in the Z$70,000s and a few

held to Z$26,000. Gono summoned the bankers again. He used "moral suasion," as one finance company executive put it, to set the interbank rate at Z$60,000 with a /-3 percent margin on either side of the buy/sell spread. However, for unexplained reasons the RBZ conveyed to the market a rate of Z$76,000 at opening of business on October 25. It then corrected the rate to Z$60,000 on October 26. Since the 26th, the commercial banks appear to have fallen in line and set their rates at about Z$60,000. Standard Chartered, for example, settled on a buy/sell rate of Z$58,000/61,000.

¶7. (SBU) Actual forex trading, however, has dried up nearly completely since the Governor,s Statement. Yvonne Nxumolo of Western Union told EconOff that Western Union handled only 16 transactions on October 25 at the Z$76,000 exchange rate. She said Standard Chartered had done five transactions. Best Doroh, Principal Economist and Senior Manager at Finhold, Zimbabwe Financial Holdings Limited, told EconOff that the weighted average exchange rate of the forex being surrendered under the new system was well below the parallel market rate. (One prominent expatriate told us he had worked at out that the effective rate was Z$50,000). The new forex regime was thus unattractive to exporters. He predicted that as long as exporters lacked confidence in the new system, the flow of funds through formal channels would remain very thin. Under the new trading regime, he added, importers would still face a major challenge in accessing forex, as the bulk would still go to the RBZ, particularly in light of a 10 percent free-fund commission the RBZ was paying on every US dollar sold to the central bank.

¶8. (SBU) Weston Makwara, Head of Treasury at Stanbic, said the RBZ had pinned its hopes on the parallel market rate converging to the Z$60,000 intermarket rate. He also said Gono had maintained at the meetings with the commercial banks that the exchange rate should be Z$35,000-45,000 based on purchasing power parity. Nxumolo, who was privy to the RBZ meetings, reported Gono,s acute disappointment and surprise at how the market had moved.

Other Highlights of Gono,s Statement

¶9. (U) In addition to presenting the new exchange rate regime, Gono also announced the following:

- The quasi-fiscal operations of the RBZ in support of parastatals were scheduled to cease by December 2006. (Comment: A key IMF recommendation; Gono clearly has his eye on the next Executive Directors Board meeting in March.)

- Statutory reserve requirements on demand and call deposits, savings and time deposits and Building Societies were reduced.

- There would be no bailouts for troubled banks, including previously prioritized "indigenized" banks.

- Interests rates on secured lending were raised to 415 percent and on unsecured lending to 430 percent.

- Annualized inflation (at 359.8 percent according to the RBZ) was "expected" to drop to 280-300 percent by December 2005 and 50-80 percent by December 2006.

- A new currency would be introduced in 2006.

- The GOZ would tolerate no further farm invasions (septel).

Comment

¶10. (SBU) Gono clearly recognizes the gravity of Zimbabwe,s forex crisis. However, his pronounced faith in the market collapsed swiftly in the face of what should have been a predictable reaction. Confronted with market forces pushing the exchange rate toward the parallel rate, he fell back on strong-arming currency traders into a "compromise." In the end, his half-baked new trading regime has sown additional confusion and uncertainty and beyond devaluing the currency has done nothing to solve the forex crisis or help pull the economy out of its nosedive. As a prominent businessman told the Ambassador at the Austrian National Day on October 25, &On Thursday we had hope. On Friday we had doubts. Now we know nothing has really changed."
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